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The Manufacturers' Organisation

MANUFACTURING OUTLOOK

2023 QUARTER 4

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FOREWORD

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As we close a year marked by figures that impressed in the first half and disappointed in the second, predictability has become vanishingly scarce. Forecasts have chased the swell of confidence and the ebb of anticlimax, washing up on the shore of 2024 eroded to just pea-sized growth prospects for the year ahead. Yet, the sector's confidence remains steadfast for the coming quarter.

Could it be that the message is getting through? Following months, arguably years, of campaigning by industry voices and advocates, a yearned-for message is emerging from Westminster: long-term business policy. The years prior have been peppered with business policy that has shifted faster than the sector has been able to capitalise upon, with post-pandemic policy philosophy enduring. While short-term interventions, such as the Super Deduction policy, have certainly not been unwelcome by the sector, their ambitions to render a systemic change in businesses' investment strategies have been misplaced. The prosperity of the sector can only be secured by creating stable long-term policy environments that businesses can grow into over the course of a decade, not twelve to twenty-four months.

It has become apparent that this understanding is now beginning to be shared by Government, as evidenced by the relevant policy announcements and commitments made by the Chancellor in the Autumn Statement toward the end of November. A *permanent* business investment policy, as seen with Full Expensing, a *doubling* of the time frame for incentives, as seen in Investment Zones, and perhaps ultimately, a *real* recognition that the Apprentice Levy scheme has been demonstrably unfit for purpose over so many years.

The value of recognition from Government that the sector requires long-term thinking as a condition for prosperity cannot be underestimated. Much of the industry has become hoarse from bellowing down the passages of Whitehall, and despite only a handful of measures delivered so far, the indication that the upcoming policy landscape will be conducive to the sectors' goals will ease the throats of a sector fatigued by operating in what it perceives as an uncompetitive business environment, especially compared to its partners and competitors across the Channel.

Still short of an Industrial Strategy, but equipped with some conciliation of an Advanced Manufacturing Plan, the sector remains a way from rummaging through the cellar to find the long-misplaced champagne. 2024 remains to be a year of little headline growth for the sector, but growing policy approval, combined with the likelihood of the open battleground of policy expected in a general election, will only further the hopes of sector-bolstering legislation. It will be anything but an uneventful time for the prospects of industry, even if balance sheets will generate little applause in the meantime.

HEADLINES

Make UK's Q3 2023 *Manufacturing Outlook* report, in partnership with BDO, finds that the overall performance of the industry is positive, despite weaknesses in order books. Last quarter indicated a sharp slowdown in activity following two quarters of expansion, but this quarter's findings suggest that it was Q3 that was the true anomaly this year.

The latest balance for output reported at +20%, up from +3% in Q3 2023, indicating that production volumes expanded on average across the sector. It is also the third quarter this year where output balances were equal to or exceeded +20%, indicating overall growth for the industry.

The marked improvement in output, however, was not matched by an improvement in total orders. The balance for total orders reported at +7% for the final quarter, and improvement from the previous quarter's -1%. However, the balance itself is less than half of the balance for output volumes growth, indicating that order books have grown much slower than production. This may reflect market slowdowns as interest rates rise to combat inflationary pressures across the globe, which is expected as high demand levels are partially responsible for higher prices. Currently, the balance of manufacturers expecting order books to expand in Q1 2024 is +16%, more than double the balance for this quarter.

negative territory with UK and export margins reporting balances of -4% and -1%, respectively.

Employment growth contracted last quarter for the first time since 2020, but has rejuvenated somewhat this quarter with a balance of +6% of manufacturers reporting increasing jobs. However, the latest balance is the second weakest this year. Investment intentions, conversely, remain strong amongst manufacturers, but have slowed following a strong third quarter reporting dropping to +10% from +17%.

Business confidence remains positive despite the turbulence in order books, indicating that future performance is expected to be more positive. Manufacturers have highlighted their ever-growing resilience, indicating that even if the market is slowing down, manufacturers are not facing a significantly difficult time ahead. However, business expectations for UK GDP have declined this quarter, reflecting the aggressive nature of interest rate hikes, signalling the Bank of England's intentions to slow down the UK economy.

INDICATOR	BALANCE	CHANGE	
Confidence	6.5	↓	Business expectations remain positive
Output	20%	↑	Output volumes growth rebounds
UK orders	0%	↑	Domestic orders flat
Export orders	10%	↑	Exports grow quickly
Employment	6%	↑	Jobs growth returns to positivity
Investment	10%	↓	Investment remains strong but slows

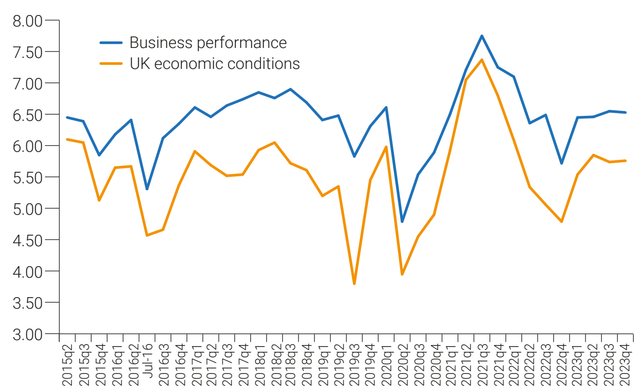
Source: Make UK Manufacturing Outlook Survey

Though the overall order book performance is not impressive, the split between domestic and export order book activity indicates a potential shift in trends. Since the beginning of the COVID-19 pandemic, UK orders outperformed export orders consistently as international markets recovered more slowly. This effect was amplified due to changes in the trading environment between the UK and EU. Now for the first time since the end of 2019, export orders growth, which reported at +10% on balance, exceeded UK orders growth, which reported at 0% on balance. Whether this is down to a genuine growth in the export scene, rather than a sign of slowdown in the domestic market remains to be seen. However, the movement observed this quarter is a positive sign for potential growth opportunities.

The share of manufacturers raising prices on their goods continues to show material signs of falling, with national statistics indicating input costs are treading on deflation which will ease cost pressures on manufacturers. UK and export price growth reported balances of +25% and +21%, respectively. Margins also continue to move in a positive direction; however they remain in

Manufacturer's expectations constant in its positivity

Confidence in the next 12 months 1 = substantially worse, 10 = substantially better



Source: Make UK Manufacturing Outlook Survey

OUTPUT

As *Manufacturing Outlook's* leading performance metric, output has subverted analysts' expectations while abiding by those of the industry set one quarter ago, an expectation forecasters did not expect in the short term.

In the previous quarter, the third quarter of 2023, output turned rapidly flat, moving on from two consecutive quarters of moderate positivity in the first half of the year. Since last quarter, forecasters' expectations have been for a continuation of this flat performance, given little sign of significant growth in industrial activity in the relatively short period between the third and final quarters of this year.

Nevertheless, the industry had expected output to return to growth in the fourth quarter, an expectation it had set in the third quarter. At the time, this was met with caution by economists, since the wider economic environment was not set to provide much room for sudden expansionary performance. Most of this assumption was tied to sustained bank rates, which have remained high and unchanged as of the time of writing.

In fact, the industry's own expectation (set in the third quarter) for the balance figure for output this quarter has been met almost exactly. The expectation was set that the sector would report a +19% balance for output here in the final quarter of the year. Now in receipt of the data, we can reveal that this balance figure for output has come in at +20% - just one percentage point above what had been expected by the sector despite spectators' doubts.

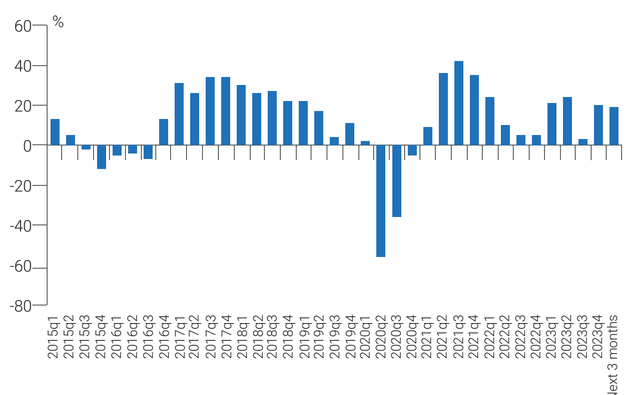
While it is not immediately apparent what has seen output performance bounce back over such a small period, effectively making the suppressed number in the third quarter of the year a 'blip', this positive signal in such an important metric is an encouraging sign for the sector as it enters 2024 in what remains to still be a high-interest rate environment.

Given the surprisingly accurate delivery of the sector's quarter-forward expectations in this edition of *Manufacturing Outlook*, we cast less doubt on the new quarter-forward expectations for the first quarter of 2024, which have been set by the sector to be a +15% balance figure for output. Nevertheless, the balance figure for orders is not growing in tandem, and as such, doubt remains as to the sustainability of the heightened output figures if orders do not soon come up to similar relative levels.

PAST THREE MONTHS ↑ 20% NEXT THREE MONTHS ↓ 15%

Output growth rebounds to meet manufacturers' expectations

% balance of change in output



Source: Make UK Manufacturing Outlook Survey

Output summary

% balance of change

SECTOR	PAST 3 MONTHS	NEXT 3 MONTHS
Basic Metals*	–	–
Metal Products	20%	-9%
Mechanical	23%	34%
Electronics	10%	10%
Electrical	26%	13%
Rubber & Plastics	-18%	36%
TURNOVER		
£0-9m	9%	13%
£10-24m	10%	10%
£25m and over	21%	33%

Source: Make UK Manufacturing Outlook Survey
* insufficient sample for this quarter

ORDERS

Following a contractionary third quarter for manufacturing performance, total orders have grown for a small balance of manufacturers. However, the growth reported in the latest quarter falls far short of the growth reported for output, indicating manufacturers are overproducing just before we head into the new year.

The reason for this behaviour is currently unclear. It may be connected to the inability to forecast demand levels accurately due to uncertainty in the economic environment, or perhaps related to manufacturers replenishing their stocks, having depleted warehouse goods to service a backlog of orders. The latter would indicate that whilst orders are not growing very quickly right now, manufacturers may be expecting growth in 2024 so are gearing up for it today.

UK ORDERS

UK orders reported a relatively improved balance of 0%, following last quarter's contractionary -2% balance. This indicates that, across the sample, an equal share of businesses reported an increase and decrease in domestic orders, leading to no genuine movement in the sector's growth for UK orders. Nonetheless, a 0% balance should still be considered positive, even if the last two quarters cumulatively indicate that growth in the domestic market may have ceased.

The results for the sub-sectoral breakdown are more mixed than anticipated. A standout balance comes from the Electronics subsector, which reported a -30% balance for this quarter. This is in sharp contrast to the previous quarter, where the same subsector reported a positive +14% bucking

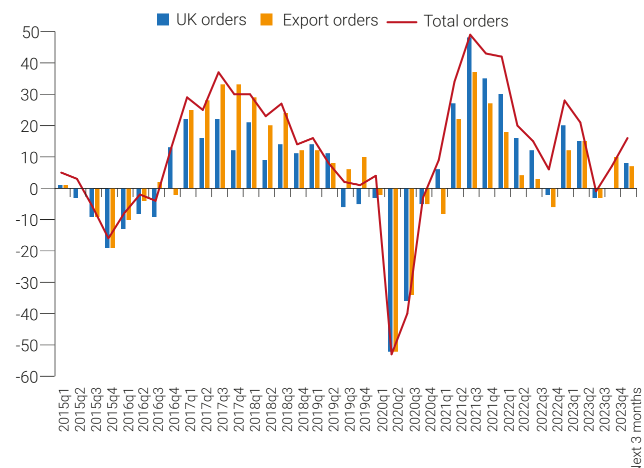
UK ORDERS	PAST THREE MONTHS	↑	0%	NEXT THREE MONTHS	↑	8%
EXPORT ORDERS	PAST THREE MONTHS	↑	10%	NEXT THREE MONTHS	↓	7%
TOTAL ORDERS	PAST THREE MONTHS	↑	7%	NEXT THREE MONTHS	↑	16%

The latest balance of +7% for total orders is a positive improvement in demand following last quarter's -1% balance. The fourth quarter performance indicates that order books are growing, though it is the second weakest performing quarter this year when compared to the highs of Q1 and Q2 in 2023. In addition, both UK orders and export orders have improved following contractions in Q3 2023.

Manufacturers forecast a stronger start to next year with more than double the current balance of businesses predicting further growth in order books. However, it is important to note that while manufacturers more confidently predicted their output this quarter, they substantially overestimated their order books, which they expected to report a balance of +26%. Significantly, although manufacturers often hold an optimistic view of the near future, it is likely that some level of uncertainty continues to impact business performance.

Export orders outgrow UK orders for the first time since 2019

% balance of change in orders



Source: Make UK Manufacturing Outlook Survey

the national trend. However, what is even more concerning is the drop in electronic orders just before the festive period, indicating the cost-of-living crisis may be damaging sales of non-essential goods.

Inspecting the data by business size highlights a familiar trend of smaller companies performing relatively less well than larger ones. Only those manufacturers in the category for £25m+ turnover bands reported a positive +8% balance for UK orders, whilst businesses in lower turnover bands reported only negative balances, indicating overall contractions.

EXPORT ORDERS

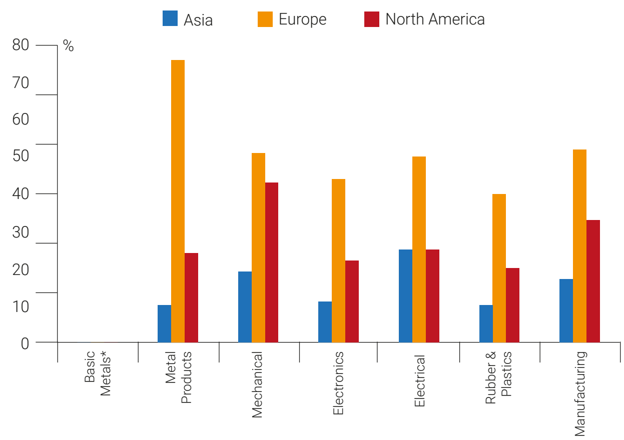
For the first time since Q4 in 2019, export orders have grown faster than UK orders. The latest balance of +10% is a significant improvement on last quarter's -3%. Exports had trailed the growth in the domestic market since the beginning of the COVID-19 pandemic, which may also be attributed partially to changes in trading relations between the UK and EU.

This quarter's reporting of growth for international sales is encouraging, but expectations should be tempered as exports are volatile to changing global conditions. In addition, the business size breakdown (by turnover) indicates that all the growth in exports were entirely driven by manufacturers with turnover that exceeds £25m, whilst those below this category experienced a contraction.

Finally, activity remains strong in the EU, with 56% of UK manufactures reporting positive demand conditions from the region. This is followed by the North America region with 33% reporting positive demand conditions. The top three is completed, as expected, by Asia, though only 17% of businesses indicated positive conditions.

Demand conditions improve for intermediate goods in Europe and North America

% of companies reporting positive demand conditions by market



Source: Make UK Manufacturing Outlook Survey
* insufficient sample for this quarter

Orders summary

% balance of change

	UK ORDERS		EXPORT ORDERS		TOTAL ORDERS	
SECTOR	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS
Basic Metals*	–	–	–	–	–	–
Metal Products	-2%	-5%	14%	-4%	11%	0%
Mechanical	8%	24%	8%	18%	15%	40%
Electronics	-30%	-10%	-14%	14%	-30%	0%
Electrical	5%	14%	21%	0%	9%	4%
Rubber & Plastics	9%	18%	0%	10%	36%	36%
TURNOVER						
£0-9m	-7%	4%	-6%	1%	1%	12%
£10-24m	-8%	2%	-9%	-4%	0%	11%
£25m and over	8%	25%	33%	29%	25%	26%

Source: Make UK Manufacturing Outlook Survey
* insufficient sample for this quarter

EMPLOYMENT & INVESTMENT

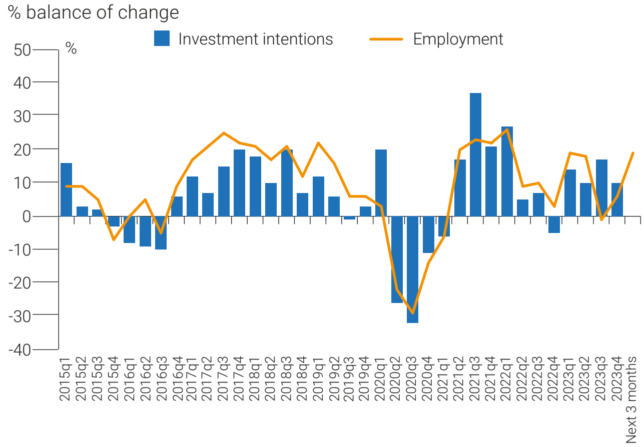
Manufacturing Outlook's Employment metric reported a balance figure just below zero last quarter, illustrating what effectively was an aggregate hiring freeze across the sector. This sudden move came as firms became rapidly uncertain of their liquidity position over the coming quarters, and looked to control the risks of a growing wage bill amongst other concerns. Despite this 'freeze', vacancies have still remained elevated in the sector and this temporary cessation in hiring growth does not indicate that the labour shortage in the sector has come to an end.

This quarter's balance figure for employment has come in at +6%, a modest improvement from last quarter's -1%, yet still well away from expansionary territory. What this figure reflects is a softening in the sudden and unexpectedly pessimistic outlook last quarter, but still a cautious view as to the trading environment in the coming first half of the year. Businesses are acutely aware that the suppressive effects of a sustained high base rate will continue to impact the sector over the coming months, and indeed year, so it's likely that this employment figure will see a slow and steady return to growth, taking the significant assumption there are no further shocks to the sector in the coming six or so months.

While investment intentions remain modest, they do remain positive which is an encouraging sign for the sector given the conditions of the capital markets at present. Expensive finance in the sector is currently acting as a risk raiser for those firms looking to make investments, with the onus on a predictable

Employment growth rebounds slightly but investment intentions slow

% balance of change



Source: Make UK Manufacturing Outlook survey

EMPLOYMENT	PAST THREE MONTHS	↑	6%	NEXT THREE MONTHS	↑	19%
INVESTMENT	NEXT TWELVE MONTHS	↓	10%			

As of November 2023, there are currently 69,000 (to the nearest thousand) live vacancies in the UK's manufacturing sector, this is a slight reduction on the 70,000 figure that was reported in the third quarter edition of this report. As a ratio, that is for every hundred jobs in the sector, 2.8 are vacant. This represents a 0.1 drop from last quarter when the ratio was 2.9. Nevertheless, this figure is still approximately 50% higher than the long-run average for twenty years prior to 2020, illustrating the consistently elevated demand for labour in the sector since the pandemic.

The future-quarter expectation for the employment balance figure from the industry has risen a little from last quarter, standing now at +19%. However, it is important to note that in the case of employment, this future-quarter expectation is more closely a proxy for demand for labour and less of a prediction from the sector of the actual rendered employment balance figure it expects to post in the next quarter.

The investment intentions metric, which measures manufacturers' intentions to invest over the coming 12 months, has declined somewhat compared to the third quarter of the year. Last quarter, the metric had bucked the trend of other metrics in the report by actually increasing, as opposed to declining in line with headline figures. In this quarter, the investment intentions balance figure reports at +10%, which is the same level that was reported in the second quarter edition of *Manufacturing Outlook*.

return on investment being more important now than it has been over the past years when borrowing rates were very low by comparison.

Employment and Investment summary

% balance of change

	EMPLOYMENT		INVESTMENT
SECTOR	PAST THREE MONTHS	NEXT THREE MONTHS	NEXT TWELVE MONTHS
Basic Metals*	–	–	–
Metal Products	4%	11%	14%
Mechanical	15%	31%	5%
Electronics	-20%	20%	0%
Electrical	9%	26%	22%
Rubber & Plastics	0%	9%	18%
TURNOVER			
£0-9m	11%	18%	11%
£10-24m	-11%	2%	-2%
£25m and over	13%	13%	28%

Source: Make UK Manufacturing Outlook Survey
* insufficient sample for this quarter

PRICES & MARGINS

In contrast to other metrics in this final-quarter edition of *Manufacturing Outlook* in 2024, Prices and Margins are beginning to show both improving and consistent trajectories. Coming off of an extended period of elevated price-setting behaviour by the industry throughout most of 2021, 2022 and the first half of 2023, price-setting behaviour has moved into a more modest pattern, despite remaining expansionary.

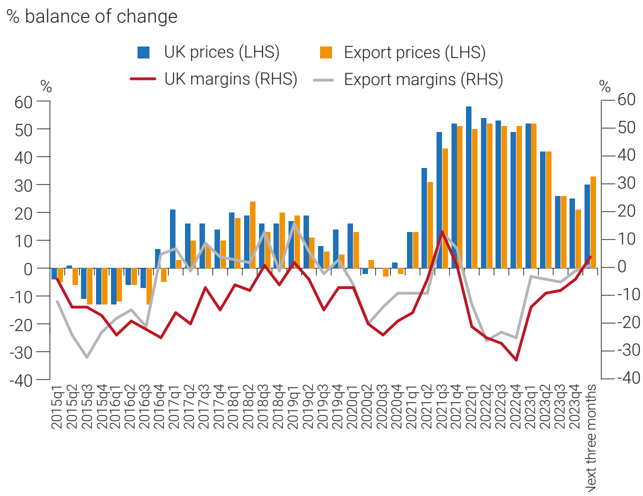
Both UK prices and Export prices have been cooling in tandem, posting balance figures of +25% and +21% respectively. While these balance figures are still very large compared to *Manufacturing Outlook's* three-decade history, relative to the past few years these figures are far less inflationary.

Price-setting behaviour has cooled faster than anticipated in the second half of this year. While this is a good indication for the wider economy that input price inflation is cooling, it has also meant the sector has had less headroom to recover margins, a metric that had seen significant contraction in the past two years. With central bank rates expected to remain at elevated levels at least into the second half of next year, we do not expect to see any sudden declines in price-setting behaviour, but rather a slow decline driven most by competition or the need to generate additional business as order books cool.

Despite this, the Margins metric has been on the path to making a recovery, albeit an extremely slow one. The latest balance figures for UK margins and Export margins are -4% and -1% respectively. While these still remain just in contraction territory, there has been a slow and steady move to them returning to positivity.

When we look at the quarter-foreword balance expectations from the sector for margins, we see that the sector expects, in the first quarter of 2024, to post balance figures for UK margins at +4% and Export margins at +1%. If this were to occur at the start of the new year, this would mark it as the first quarter since the end of 2021 that margins in either case had moved into positive territory.

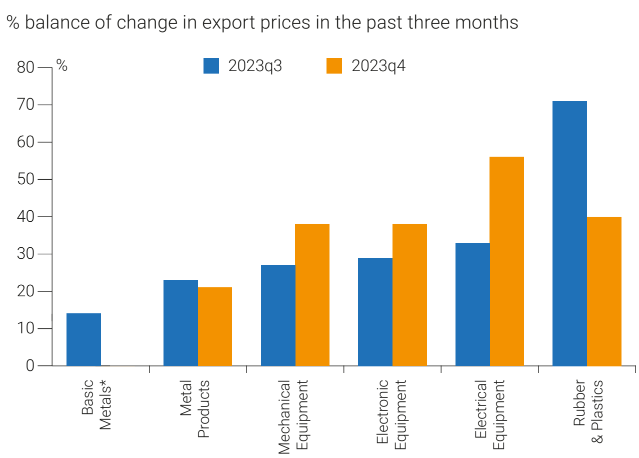
The share of manufacturers raising prices slows further, and margins continue to recover



Source: Make UK Manufacturing Outlook Survey

UK PRICES	PAST THREE MONTHS	↓	25%	NEXT THREE MONTHS	↑	30%
EXPORT PRICES	PAST THREE MONTHS	↓	21%	NEXT THREE MONTHS	↑	33%
UK MARGINS	PAST THREE MONTHS	↑	-4%	NEXT THREE MONTHS	↑	4%
EXPORT MARGINS	PAST THREE MONTHS	↑	-1%	NEXT THREE MONTHS	↑	1%

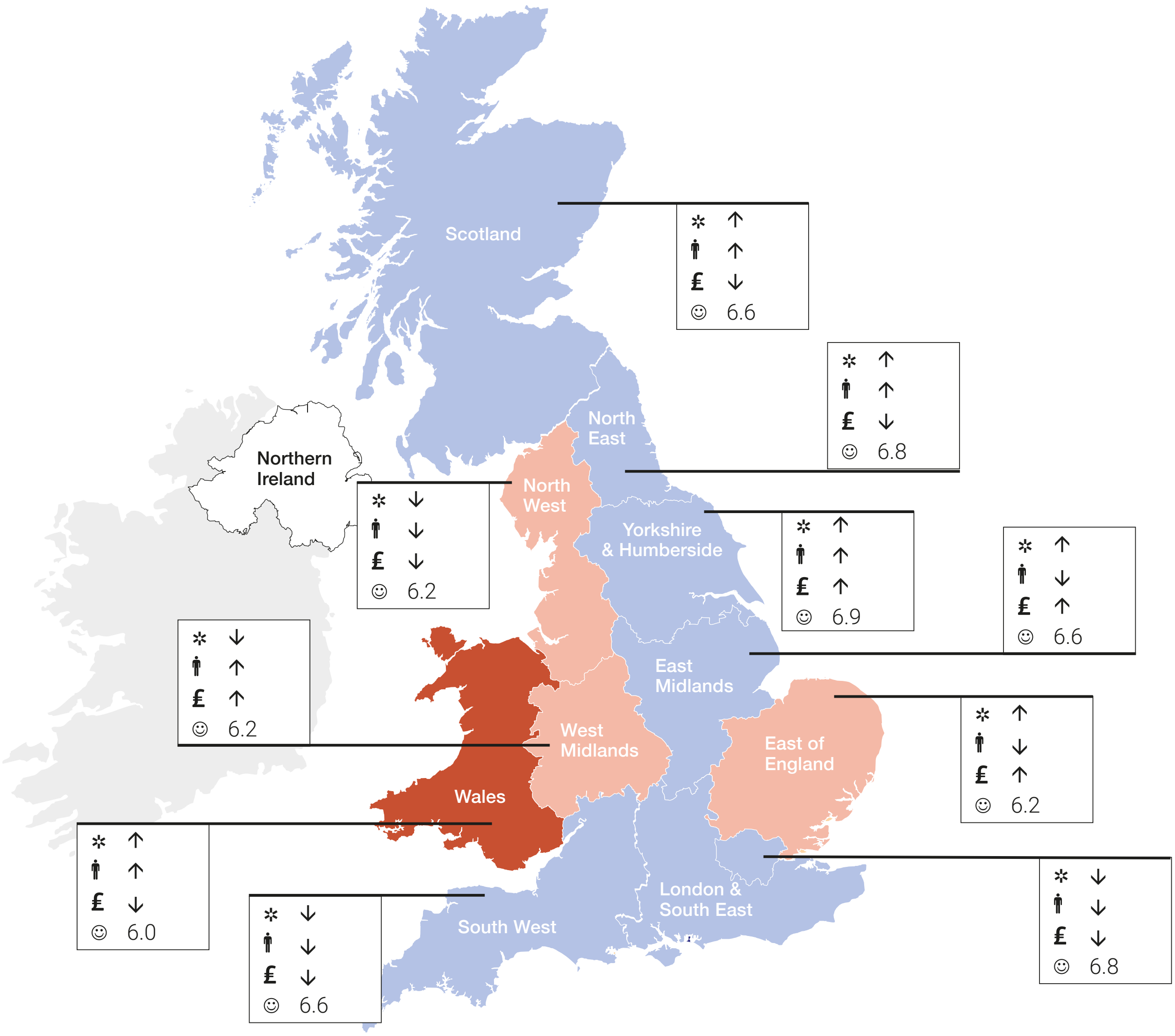
Many goods for exporting see their prices increase



Source: Make UK Manufacturing Outlook Survey
* insufficient sample for this quarter

NATIONAL & REGIONAL

Confidence amongst manufacturers appears to be taking a path contrary to the other more volatile metrics, namely output and orders. Since the beginning of 2023, both business confidence and UK economy confidence has only shifted by small margins, with the majority of manufacturers maintaining a positive view of their environment.



KEY:

↑/↓ INCREASE/DECREASE ON PREVIOUS QUARTER
✲ OUTPUT
🕴 EMPLOYMENT
£ INVESTMENT
☺ BUSINESS CONFIDENCE

The map is coloured according to the business confidence levels difference from average UK business confidence

HIGH CONFIDENCE

LOW CONFIDENCE

Source: Make UK Manufacturing Outlook Survey

The lack of disruption observed in the metric for confidence may reveal a behavioural change amongst businesses who have grown accustomed to a topsy-turvy mode of operation. This year was far from free of disruption, with high levels of inflation in the cost of inputs, supply chain challenges, and labour shortages impacting manufacturers' activities. However, in the last few years, the very same businesses have navigated similar uncertainty arising from leaving the EU, a global pandemic and an unprecedented energy cost crisis, so are perhaps demonstrating greater resilience to such challenges.

Indeed, it is possible that recent events now pale in comparison to what industry has become used to, and so optimism has become much more difficult to shake. Nevertheless, expected confidence levels are not equal across all regions, though in the latest quarter, the discrepancies between different areas of the UK are much smaller than previous quarters.

Overall, all regions and nations in the UK maintain positive business confidence (above the '5' inflexion point). This is similar for confidence in the UK economy, excluding Wales, which is the only nation to report negative confidence (below 5).

It is positive to observe the resilience of UK manufacturers, but 2024 may bring additional challenges. As an election year, there will be some uncertainty as to whether the political climate could change and what impact this may have on Government policy.

Headline business confidence reported at 6.5, which is a minor decline on last quarter's level.

The largest improvement in business confidence was reported by Scotland, which increased by 1 point to 6.6. The region with the highest business confidence in the UK is Yorkshire & the Humber, reporting at 6.9. The next two most confident regions are the North East, and South East and London, who jointly reported a 6.8 on the optimism scale.

The North West reported the largest negative change in business confidence in the last three months, falling by 0.8 to 6.2. Whilst the region remains very optimistic, it ranks low in comparison to most parts of the UK. The manufacturers with the (relatively) lowest reported business confidence, though they are not pessimistic about their future, are those based in Wales, with an average score of 6.0. These businesses are followed by the North West, West Midlands, and East of England, who all reported an average confidence of 6.2.

Despite slow growth in order books, particularly in the domestic market, it is evident that most manufacturers expect the next 12 months will be more positive than negative.

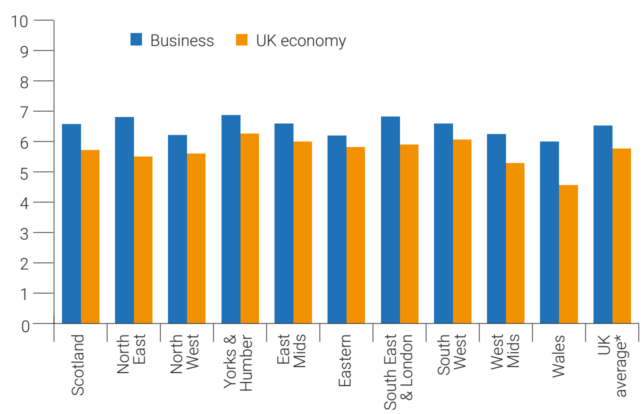
UK ECONOMY CONFIDENCE

Manufacturer's confidence in the overall UK economy reported at 5.8, a minor improvement on the previous quarter level.

The improvement in UK economy confidence was expected, as many analysts and forecasters updated their predictions for the nation's GDP. Though most forecasts indicate the UK will avoid a recession, they do not expect significant growth either. However, UK economy expectations are historically more volatile than business confidence, as external factors play a more significant influencing role. Manufacturers will need to keep an eye on how costs change and whether interest rates will continue to rise next year.

All UK regions and nations report positive business confidence

Confidence in the next 12 months 1 = substantially worse, 10 = substantially better



* Average =/= component parts due to instances of undeclared regionality

Source: Make UK Manufacturing Outlook Survey.

Regional summary

% balance of change

	OUTPUT		TOTAL ORDERS		EMPLOYMENT	
REGION	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS
Scotland	10	17	-3	10	14	26
North East	60	50	60	60	10	20
North West	-6	6	22	6	-11	17
Yorks & Humber	47	53	27	67	0	20
East Mids	12	0	-6	-12	0	0
Eastern	5	15	0	10	-14	-5
South East & London	7	26	7	31	2	7
South West	13	0	7	0	7	-20
West Mids	0	5	0	33	14	29
Wales	86	-29	29	-29	43	-29

Source: Make UK Manufacturing Outlook Survey

ECONOMIC ENVIRONMENT

The economic and business environment continues to impact manufacturers' expectations as they head into 2024. Following 14 back-to-back increases in the base interest rate, the Bank of England (BoE) have since paused further increases to the cost of debt. This is because the Office of National Statistics (ONS) monthly reporting of consumer inflation has been rapidly cooling, following reductions in the energy price cap and falling fuel costs.

However, several challenges remain, from labour shortages to a cost-of-living crisis that manufacturers will need to be agile to deal with for the coming year. In addition, next year's expectations will be heavily influenced by the political climate, as an election looms without an official date.

The Chancellor recently outlined various measures in the 2023 Autumn Statement to rebalance the economy with incentives for investment, such as making the full expensing capital allowances regime permanent, which will undoubtedly support manufacturers' investment planning.

The importance of making 100% capital allowances permanent should not be understated. Though the scheme does not lead to any real long-term cash flow benefit in terms of corporation tax owed, it sends a strong message to the international community about the UK being a good place to invest. Indeed, according to the Tax Foundation, all things being equal, the UK is now the 5th best country in the OECD in terms of how generously it treats taxation in relation to capital expenditure. Previously the UK ranked 30th out of 36 countries.

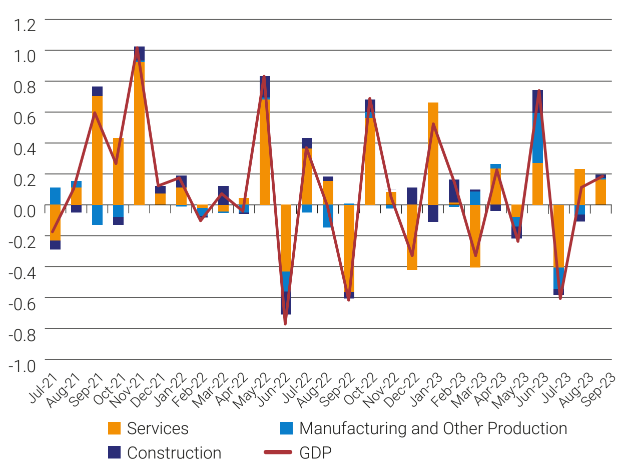
Nevertheless, several headwinds remain, such as the rising cost of business rates. The Treasury only opted to freeze the multiplier for small business – in other words, for those that occupy properties valued at less than £51,000. Unfortunately, this means that about 70% of manufacturers will see no reduction in the tax burden through their business rates, which may work against generous tax reliefs. Furthermore, the Chancellor also announced changes to R&D tax credits, one of the more heavily utilised tools by manufacturers to support innovation. By combining the R&D expenditure credit and SME scheme into one, HMT intends to simplify and we can hope to see easier access to funds.

Finally, in a major announcement in the Autumn Statement which will impact manufacturers next year, the Government raised the national living wage by more than 10% and committed £50mil to increase the availability of engineering apprenticeships. Labour and skills remain a critical area of concern for manufacturers, so it will be interesting to monitor whether the funding for apprenticeships will be able to counter the negative impact of the apprenticeship levy, which has reduced apprenticeship starts by nearly 40% since its introduction.

Expectations for economic growth are mixed across the global economy. According to Oxford Economics (OE), world GDP growth is expected to reach 2.6% by the end of this year and grow by 2.1% in 2024. That is in stark contrast to the Office of Budget Responsibility's (OBR) predictions for the UK economy, which stand at 0.6% for 2023 and expects growth of 0.7% in 2024. Interestingly, in the latest OE forecast for Germany, the country's GDP is expected to contract by 0.2% this year, which may reflect the impact of high energy costs and rising unemployment.

GDP grew by nearly 0.2% due to expanding services

Contributions to monthly GDP, percentage points, July 2021 to September 2023



Source: ONS

In terms of inflation, the ONS reported in its most recent summary that consumer price growth slowed to 4.6% in the 12 months up to October 2023. This is a sharp drop from its peak which exceeded 10%, and indicates that earnings may slowly begin to catch up to the high cost of living. However, despite the headline rate, cooling food inflation remains in double digits (10.1%), which will continue to burden consumer pockets.

On the other hand, producer inflation for both inputs and outputs (factory gate prices) are walking a deflationary path now. The most recent update reported input inflation currently down by 2.6%, and output inflation down by 0.6%. According to the ONS, downward contributions from food and fuel were the main factors for this decline, which suggests consumer inflation could slow down even further in 2024.

A significant area that manufacturers will need to be wary of next year are further developments in the Trade Cooperation Agreement (TCA), the trade agreement between the UK and EU. There are several aspects of the TCA that are yet to be fully implemented, such as the Target Operating Model (TOM) and various agreements on regulations. There will be opportunities to progress negotiations next year, which may positively or negatively impact manufacturing imports and exports.

UK Economic Forecasts

% change except where stated

	2022	2023	2024
TRADING ENVIRONMENT			
Exchange rate (€/£)	1.13	1.16	1.15
Exchange rate ($/£)	1.2	1.22	1.24
Exports	10.3	-0.2	1.5
Imports	12.6	-0.2	2.6
Current account (% GDP)	-4.7	-2.8	-2.6
OUTPUT			
Manufacturing	-4.8	0.8	0.1
GDP	4.0	0.6	0.4
COSTS AND PRICES			
Average earnings	6.0	7.2	4.6
Oil price (Brent Oil $/bl)	100.8	82	82
EMPLOYMENT			
Manufacturing (000s)	2,628	2,612	2,552
Rest of economy (000s)	36,046	36,689	36,507
Unemployment rate (%)	3.7	4.2	4.5

Source: Oxford Economics and Make UK

International Economic Forecasts

% change

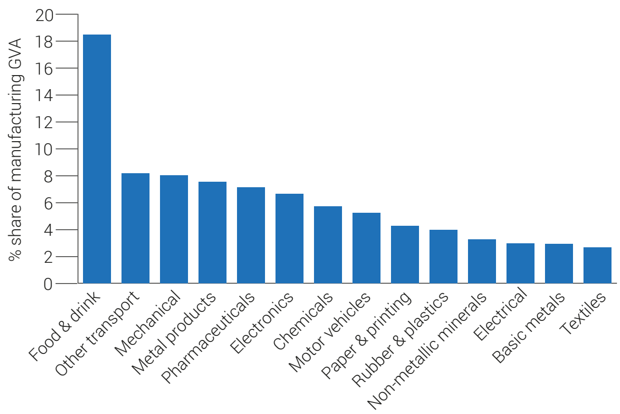
	GDP			INFLATION		
	2022	2023	2024	2022	2023	2024
US	2.1	2.4	1.0	4.7	4.2	3.0
Eurozone	3.5	0.5	0.6	20.2	5.5	1.5
France	2.6	0.9	0.6	1.6	4.9	2.0
Germany	1.9	-0.2	0.1	3.1	5.9	0.9
Japan	1.3	1.7	0.7	-0.2	3.1	1.8
China	3.0	5.2	4.4	0.9	0.4	1.5
India	6.9	6.7	5.7	5.1	5.8	4.8
World (US$ weighted)	3.1	2.6	2.1	7.8	6.1	4.4

Source: Oxford Economics

SECTOR FORECASTING 23Q4

Q4 2023 Manufacturing Sector composition by GVA (% share)

Subsector share of Manufacturing Gross Value Added



Source: Oxford Economics

Note: Some Q4 output forecasts have remained consistent with their Q3 revisions.

FOOD & DRINK

The **Food & Drink** subsector is the largest manufacturing subsector in the UK, accounting for 18.5% of all manufacturing Gross Value Added (GVA) in the latest data. The subsector has not seen any revision to its output forecast for 2023 when compared with last quarter, standing at -0.2%. This represents an almost entirely flat forecast in terms of output growth for the subsector this year. 2024's output forecast also remains steady at 0.2%, indicating that the subsector's growth expectations are effectively flat for the year ahead as well. Employment is expected to contract by -2.5% in 2023, and further by -2.8% in 2024.

ELECTRONICS

The **Electronics** subsector saw an upward revision to its output forecast for 2023 last quarter, improving by just over a percentage point up to 5.6% growth expected. The fourth quarter forecast for the subsector has remained at 5.6% growth expected for 2023. The continued relative easement in lead times for the sector's inputs continues to unshackle the sector's prospects, prospects that had been significantly limited by delays in Eastern inputs in 2022. However, once this unlocked potential has been rendered, the subsector is forecast to return to a relatively flat position in 2024, with a -0.5% decline in growth expected. Employment is expected to decrease a little in 2023 with a -0.8% change this year and a further decline of -3.6% in 2024.

BASIC METALS AND METAL PRODUCTS

The **Basic Metals** subsector has seen continued upward revisions to its forecast, albeit while still remaining negative. Forecasts for the subsector at the end of 2022 and at the start of this year were particularly negative. The latest expectation for output growth in 2023 is -1.3%, an increase by a tenth of a percentage point. What's more interesting, and moreover concerning, is the significant decline in output expected in 2024, which has softened somewhat since the last round of forecasting in the third quarter of this year. The output forecast for 2024 is a decline of -6.2%, the most contractionary 2024 output forecast of all subsectors. Employment is set to follow suit, with a reduction of -6.9% in 2023, and a further reduction in 2024 by -4.0%.

The **Fabricated Metals** subsector continues to see its performance diverge from that of the Basic Metals subsector, two subsectors that are typically linked in their prospects by the nature of their products. The output forecast for the Fabricated Metals subsector has improved again, up by approximately a percentage point to 3.4% growth in output expected in 2023. Continued modest growth is forecast for 2024, at 0.8%, which is above the manufacturing sector average in 2024 for growth, which stands only at 0.1%. Employment growth is set to be strong this year but contract the next, with a growth of 5.5% in 2023 and -2.3% in 2024.

MECHANICAL EQUIPMENT

The **Mechanical Equipment** subsector's forecast has improved a little in the short term and in the longer term. Output growth in the subsector is forecast to decline by -2.8%, which is a tenth of a percentage point improvement compared to the last round of forecasting. In 2024, the subsector's output is expected to decline by -0.9%. The subsector often acts as a recipient of domestic capital expenditure from other firms in the UK, and as such, the slight decline in the sector's investment intentions may yet still weigh on this subsector's prospects in the coming year. Employment is forecast to decline both this year and next, with a contraction of -2.5% expected in 2023, and a contraction of -2.3% in 2024.

TEXTILES

The **Textiles** subsector holds one of the more negative forecasts for output decline in 2023, despite the figure having been slightly revised upward since the third quarter's round of forecasting. Having improved by just under a tenth of a percentage point, the latest forecast for the subsector signals a decline of -5.4% in output in 2023, but with a modest return to growth in 2024 of 1.1%. Employment is set to decline substantially this year by -6.8%, with a smaller decline of -3.4% expected in 2024.

PAPER & PRINTING

The **Paper & Printing** subsector had previously enjoyed a significant improvement to its output forecast for 2023, despite remaining negative. The second quarter of 2023 quarter saw a particularly negative outlook for the subsector, with a -6% decline in output expected, now the revised fourth-quarter forecast expects a more moderate decline in 2023 output by -2.8%. Nevertheless, prospects for 2024 remain in contraction, with a commensurate decline of a further -2.7% in output in 2024. Employment is set to grow this year but decline the next, with an increase of 6.3% in 2023 and -2.7% in 2024.

ELECTRICAL EQUIPMENT

The **Electrical Equipment** subsector had received a stunning improvement in its output prospects for this year in prior forecasts. Having previously held the most negative output forecast for 2023 in the first half of the year, the latest forecast expects a decline in output at a far more moderate -3.5%, a significant improvement from the previously forecast -6.8% in H1. However, that decline is expected to continue into 2024, with a further drop of -4.1% of output forecast. Employment expectations are less drastic, with a decline of -2.6% forecast for 2023, and 0.8% growth in 2024.

NON-METALLIC MINERALS

The **Non-metallic Minerals** subsector is best known for manufacturers that primarily supply the construction market with bricks, mortar, glass and other such materials. As such, its performance is closely linked with the UK's construction market. The subsector continues to hold the most negative forecast for a relative decline in output in 2023 at -6.9%. This effect is not expected to be sustained into 2024, with a flatter change of only -0.3% in output forecast. Employment, on the other hand, is expected to increase slightly in 2023, by 0.7% and decrease in kind in 2024 with a contraction of -1.0%.

PHARMACEUTICALS

The **Pharmaceuticals** subsector, has so regularly held one of the most expansionary forecasts for output growth since the inception of the pandemic and continues to do so for 2023, holding the second largest. The subsector's output forecast has been revised upward by approximately a tenth of a percentage point to 7.1% growth in output for 2023. However, its prospects for 2024 remain unchanged compared to the previous round of forecasting, with a moderate growth of 1.5% forecast for 2024. Conversely, the subsector is expected to decline in employment for 2023, at -2.1%, and an even larger negative forecast for employment decline of -6.1% is projected in 2024.

CHEMICALS

The **Chemicals** subsector continues its trend of divergent performance from that of its close neighbour the Pharmaceuticals subsector, with a decline of -5.4% in output forecasted for 2023. This is an ever so slight improvement on the previous quarter's forecast, with only a two-tenth percentage point increase. As we see across most of the sector for 2024, the output growth forecast is flat for next year, with only 0.3% growth expected. Employment in the chemicals subsector, similarly to its close cousin pharmaceuticals, is expected to decline in both 2023 and 2024, by -8.5% and -2.8% respectively, meaning the subsector holds the most negative forecast for employment decline for 2023 out of all subsectors.

RUBBER & PLASTICS

The **Rubber & Plastics** subsector, having seen little change to its prospects for 2023 last quarter, remains close to a no-change output growth forecast in 2023 of -0.4%. 2024 expectations have stayed consistent since the previous round of forecasting, now standing at -1.4% for 2024, having previously been the positive equivalent in the first half of the year. Employment is forecast to contract in 2023, by -2.6%, and decline by a smaller measure of -0.6% in 2024.

MOTOR VEHICLES (AUTOMOTIVE)

Holding by far the largest positive output growth forecast this quarter again, the **Motor Vehicles** subsector has seen its forecast for output growth in 2023 remain high at 12.6%. The subsector has been subject to volatile forecasts over the past year and a half due to a boom and bust in expectations caused largely by varying expectations in supplier lead times for the subsector's inputs. This growth in output is expected to be a short sprint, however, as growth is forecast to return to a modest 2.5% in 2024. Employment will also contract a little this year, by -0.1%, and is forecast to decline by -3.7% in 2024.

OTHER TRANSPORT

The **Other Transport** subsector, which is comprised of aerospace, defence, shipping and rail industries, has received a very small improvement to its already positive output forecast for 2023, by a tenth of a percentage point. Now standing at 3.2% growth in output for 2023, and a similar 3.3% in 2024, the subsector's forecasts exceed the manufacturing average across both years. Employment is forecast to grow and decline between this year and the next, with an expansion of 0.5% forecast this year, before a contraction in 2024 by -1.3%.

Sector growth rates and forecasts

% change

	OUTPUT			EMPLOYMENT		
	2022	2023	2024	2022	2023	2024
Basic metals	1.4	-1.3	-6.2	3.0	-6.9	-4.0
Metal products	-11.1	3.4	0.8	0.8	5.5	-2.3
Mechanical	-10.3	-2.8	-0.9	1.4	-2.5	-2.3
Electronics	-5.9	5.6	-0.5	1.5	-0.8	-3.6
Electrical	-12.4	-3.5	-4.1	6.1	-2.6	0.8
Motor vehicles	-12.0	12.6	2.5	0.3	-0.1	-3.7
Other transport	-4.7	3.2	3.3	2.8	0.5	-1.3
Food & drink	0.5	-0.2	0.2	0.4	-2.5	-2.8
Chemicals	-5.5	-5.4	0.3	4.0	-8.5	-2.8
Pharmaceuticals	-3.3	7.1	1.5	7.0	-2.1	-6.1
Rubber and plastics	-9.7	-0.4	-1.4	4.7	-2.6	-0.6
Non-metallic minerals	3.1	-6.9	-0.3	2.7	0.7	-1.0
Paper and printing	-5.7	-2.8	-2.7	3.2	6.3	-2.7
Textiles	-3.3	-5.4	1.1	7.9	-6.8	-3.4
Manufacturing	-4.8	0.8	0.1	3.4	-0.8	-2.3

Source: Oxford Economics

Source: Oxford Economics

BDO VIEWPOINT

MANUFACTURING GROWTH THROUGH INVESTMENT

UK manufacturers have ended the year with a rebound in both output and employment, following a fall in output last quarter. However, manufacturers' investment intentions have failed to continue the growth seen earlier this year, despite improving margins.

Sustaining investment in the manufacturing sector is key for driving growth and efficiencies, whether that is investing in machinery, digitalisation, or people. The Autumn Statement was a welcome one for the UK manufacturing sector, addressing some long-standing concerns and providing some much-needed support. Going into 2024 there are some key announcements UK manufacturers should be aware of.

ATTRACTING FOREIGN INVESTMENT

Between measures to encourage foreign investment into UK manufacturing businesses and direct investment into the automotive and aerospace sectors, the government gave a strong economic commitment to the manufacturing sector and businesses of all sizes.

PLUGGING THE SKILLS GAP AND LABOUR SHORTAGES

Many announcements also sought to address shortcomings in the supply of labour which is a common issue across the manufacturing space. Measures were announced to fund apprenticeships in growth sectors to upskill the workforce and smooth the adoption of beneficial technologies, while others try to encourage people back into the workforce. The sector had made calls for the government to go further including a full review of the apprenticeship levy and tax reliefs for investing in apprentices and training.

CAPITAL INVESTMENTS

The UK manufacturing industry has asked for greater forward-looking certainty for capital allowances for some time. The announcement of permanent "full expensing" relief for investments in capital assets will be welcomed across the sector. This predictability will give businesses greater comfort as they make long term investment decisions in new technologies.

STREAMLINING R&D TAX CREDITS

The Government intends to expand and simplify the available tax incentives for growing businesses by merging the SME and RDEC research and development incentives from April 2024. This should reduce the administrative burden for manufacturers over time but the detail of the rules for subcontracted R&D is yet to be clarified. Startups and other loss-making SME manufacturers that qualify as R&D intensive will also continue to benefit from a higher rate of tax relief under a standalone scheme to help their growth and development.

For SMEs that don't qualify as R&D intensive, the effective rate of relief under the merged R&D scheme is lower but can still provide valuable financial support to a business that is investing in innovation and developing new processes, products or services. Relief under the merged scheme will provide a taxable ('above the line') credit of 20% of the qualifying expenditure. This credit is effectively offset against the company's UK corporation tax liability or, subject to some limits, can be claimed as a direct payment giving loss making R&D heavy businesses a much needed cash flow boost.

INVESTMENT ZONES

As a sector with significant representation throughout the supply chain in the regions, the announcement of three more Investment Zones could benefit the manufacturing sector in particular, even though some of the benefits may have been eroded by the "full expensing" announcements.

Manufacturers need certainty in the tax environment to support their long-term investments in the UK. Making capital allowances "full expensing" permanent, investing in the workforce of tomorrow and extending the available tax reliefs for Investment Zones all give manufacturers a greater ability to plan and forecast for future investments.

Read our full Autumn Statement analysis here.

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Make UK works for the success of more than 2.7 million men and women employed in UK manufacturing. Representing member companies – from small businesses to multinationals – across every industrial sector, we are the most influential voice of manufacturing, enabling our members to connect, share and create opportunities together.

We stimulate success for manufacturing and technology related businesses, enabling them to meet their objectives and goals. We empower individuals and inspire the next generation.

We create the most supportive environment for UK manufacturing growth and success and we represent the issues that are most important to our members, working hard to ensure UK manufacturing remains in the government and media spotlight.

Our extensive knowledge of manufacturing means that we're able to influence policy-making at local, national and international levels. We push for the policy changes that our members want to see. We are the voice of manufacturing.

MakeUK.org

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The data used in this survey have been provided by UK manufacturers including members of Scottish Engineering, Manufacturing NI, and Make UK. Contributing to our surveys helps to accurately reflect trends and behaviours that shape the UK manufacturing sector. If you would like to participate in future surveys, please contact our Information and Research team research@Makeuk.org

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Accountancy and business advisory firm BDO LLP is the UK member firm of BDO International, which has more than 1,700 offices in 164 countries. We operate from 18 offices across the UK, employing 7,070 people offering tax, audit and assurance, and a range of advisory services.

Manufacturing is a priority sector for BDO and this focus enables us to tailor the wide range of services we offer and apply our skills and knowledge to help clients achieve their objectives.

We provide real solutions to industry issues, utilising our capabilities in everything from sector-specific accountancy, tax and business advice to patent box and research and development claims and M&A opportunities to help our clients grow in the UK and overseas. We also provide manufacturing businesses and organisations with robust, independent audits.

We have an excellent understanding of the issues affecting UK manufacturers as an industry sector, but we also focus on specific sub-sectors to improve our knowledge and our service to clients. These include: advanced manufacturing, aerospace, automotive, building products, chemicals and pharmaceuticals, food and drink, electronics, industrials, test and measurement and technology.

Manufacturing remains one of the key industries of the UK economy. We are delighted to be able to play an active role in supporting the businesses that operate in this vibrant, changing and challenging sector. For further information about our business and services, please visit our website: **www.bdo.co.uk**

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